Decision **REVISED PROPOSED DECISION OF ALJ RYERSON**
(Mailed 12 / 7 / 2001)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the operations, practices, rates and charges of the Hillview Water Company, Inc., a corporation, and Roger L. Forrester, the principal shareholder and president, Respondents.	Investigation 97-07-018 (Filed July 16, 1997)

David Ebershoff, Attorney at Law, for Hillview Water Company, Inc., and Roger L. Forrester, respondents.
Jane Cavin, for Richard T. and Jane Cavin; Dan Devor, Duane Butch Carpenter, for Department of Justice, Bureau of Investigation, Steven D. Wells, for Longs Drugs, Edwin Butterworth, James R. Hauer, and John Minich, for themselves; interested parties.
Peter G. Fairchild, Legal Division, and Daniel R. Paige, Water Division Ratepayer Representation Branch, for Water Division.

INTERIM OPINION ON PROPOSED SETTLEMENT AND PETITION FOR MODIFICATION

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INTERIM OPINION ON PROPOSED SETTLEMENT AND PETITION FOR MODIFICATION

I. Summary

This interim decision addresses the Motion for Adoption of Settlement (Motion) jointly filed on November 22, 1999, by the Ratepayer Representation Branch (RRB) of the Water Division (WD), and Hillview Water Company, Inc. (Hillview), one of the respondents in this investigation. The Motion asks us to adopt a written settlement agreement (Settlement), executed as of the same date by RRB and Hillview, as "a complete resolution of all issues in the present proceeding." The Motion is denied.

We also address Hillview's Petition to Modify Order (Petition), filed September 20, 2000, which asks us to modify our Order Instituting this Investigation (OII). Hillview asks us to delete from the OII a requirement that any proposals to increase rates or charges submitted to us on behalf of Hillview be consolidated with this enforcement proceeding for consideration. The Petition is granted in part.

II. Background and Procedural History

Hillview is a small investor-owned water company that serves the communities of Oakhurst and Coarsegold in Madera County. At the time of the events under investigation it served approximately 1300 customers, although its service area is developing rapidly. Respondent Roger L. Forrester (Forrester) is the company's president, and one of its two shareholders.

RRB was a branch of the WD.[1] Since January 1998 it has handled all formal water proceedings, and represented the interests of Hillview's customers in this proceeding following a transfer of authority from the Large Water Branch (LWB) of the WD.

In their Motion Hillview and RRB propose that we adopt the Settlement as "a complete resolution of all issues in the present proceeding" (p. 3). We instituted the proceeding, a broad inquiry into Hillview's management activities, on the basis of the results of a WD audit and review of Hillview's operations that disclosed a number of apparent irregularities in its accounting methods, dealings with customers, and reporting of information to the Commission. WD asked the Commission's Consumer Services Division (CSD) to pursue a formal enforcement action, and CSD sought an order from us to initiate this formal investigation. In response we opened Investigation (I.) 97-07-018 by issuing the OII on July 16, 1997.

The OII states that our investigation will review alleged violations of statutes and regulations we enforce, and impose sanctions, order refunds, and establish rates, as appropriate. It also states that we knew the (California) Department of Justice was investigating respondents Hillview and Forrester.

The OII characterizes CSD's supporting allegations as "serious." According to the OII, CSD asserted it could demonstrate that the respondents violated a number of basic regulatory requirements, and submitted falsified documents or inaccurate information to the Commission. The respondents were placed on notice of the following specific CSD allegations:

[1] After the OII was issued, RRB became part of our Office of Ratepayer Advocates.

1. The respondents violated the terms of prior Commission orders and instructions to water utilities on how utilities are to extend service to new customers.
2. The respondents submitted to the Commission staff copies of service extension contracts which had pertinent information blocked out during reproduction.
3. The respondents charged customers unauthorized fees for the connection of service and, in turn, rebated the amounts in contravention of tariff and service extension requirements to shopping center developers.
4. The respondents diverted revenue collected expressly to repay a Safe Drinking Water Bond Act (SDW) loan from a special account, and applied the money to funds for other purposes, including Forrester's personal business dealings, in violation of Decision (D.) 91560 and D.87-09-029. Included under this allegation is an additional assertion that in submitting Advice Letter (AL) 53 to seek greater authority to expand facilities and increase indebtedness, Hillview misstated the level of the special fund account because it had diverted funds to other uses.
5. The respondents overstated long-term debt and Hillview's plant account by showing loans obtained by Forrester for personal business as utility purpose indebtedness and for expenditure on plant used by the water utility.
6. The respondents secured a $350,000 personal loan from a developer, then asked the Commission for authority to receive a Small Business Administration (SBA) loan to repay it, without disclosing that the loan being repaid was for a personal or non-utility purpose.

The OII placed both Forrester and Hillview on notice that they could be fined or sanctioned for these activities, if proven.

The OII ordered a prehearing conference (PHC) to be held expeditiously before an Administrative Law Judge (ALJ), and directed CSD staff to serve its audit or investigatory report on the respondents not more than ten days before

the PHC. No report was prepared by CSD. Instead, LWB prepared a report.[2] That report (1997 Report) was not completed until late November 1997, and the first PHC was held on December 4 in Oakhurst.

Counsel from the Commission's Legal Division appeared on behalf of the LWB at this PHC. Appearances were also made in this proceeding on behalf of Mr. and Mrs. Richard Cavin (Cavin), aggrieved customers who had earlier filed Case (C.) 96-07-003 alleging related (and apparently overlapping) tariff violations by Hillview, and by six other interested parties.

Both respondents appeared at the PHC through attorney David A. Ebershoff (Ebershoff). He made the following representations on behalf of his clients:

> "We . . . have a scheduling issue that needs to be addressed today, and that is that as the PUC is aware, . . . substantially all of the company's documents are currently in the possession of the State Department of Justice, and we are not in the position to go forward in this proceeding until we have access to the documents . . . " (Tr., December 4, 1997, p. 19.)

The ALJ directed the respondents to file a written motion if they sought to stay the proceeding on such grounds, and they subsequently filed that motion.

III. The 1997 Report

As explained above, the 1997 Report had been issued shortly before the December 4 PHC, and copies were sent to customers and made available for

[2] From October 1996 until January 1998 LWB was responsible for reviewing refinancing for, and auditing of, Hillview.

public distribution at the PHC.[3] The 1997 Report makes the following findings about Hillview's conduct:[4]

1. Hillview demanded and charged its customers fees in violation of several provisions of the Pub.Util. Code, and violated Pub. Util. Code Section 581 and Rule 1 of the Commission's Rules of Practice and Procedure (Rules) by providing false information to the Commission. Specifically, LWB found that Hillview withheld the true number of customers who paid unlawful fees for supply and storage, understated the amount it collected from such fees, and misrepresented certain facts to LWB during its audit.
2. Hillview submitted falsified documents to the Commission in violation of Pub. Util. Code Section 581 and Rule 1.
3. Hillview caused the Commission to authorize Hillview to obtain a loan from the National Bank of Cooperatives (CoBank) in excess of what otherwise would have been needed after using the loan proceeds to repay its loan from DWR.
4. Hillview violated Pub. Util. Code Section 827 by knowingly making false statements or representations to the Commission, thus influencing the Commission to authorize Hillview to issue evidence of indebtedness.
5. Hillview obtained Commission authorization for another loan from CoBank, in the amount of $540,000, by representing that the loan was intended to refinance

[3] The 1997 Report consists of two volumes, a narrative volume with the investigators' explanation of the audit, findings, and recommendations, and a volume of exhibits. These have respectively been marked as hearing exhibits (Exs.) D-1 and D-2.

[4] In addition to these findings, LWB also concluded that Forrester was guilty of perjury because of the role he personally played in verifying annual reports, and that he had violated Pub.Util. Code Section 827 by knowingly making false statements or representations before the Commission.

obligations of the utility, then used part of the loan proceeds to repay a personal loan of respondent Forrester and his wife.

6. Hillview violated Pub. Util. Code Sections 818 and 825 by failing to obtain prior Commission authorization for certain loans, and by underreporting the amounts of the loans it had obtained.

7. For 1994, the test year on the basis of which its present rates were adopted, Hillview overstated its ratebase in the amount of $132,386 by overstating its account for plant in service and understating contributions in aid of construction (CIAC). This resulted in the adoption of rates to produce annual revenues of $24,080 higher than should have been authorized.

8. Hillview overstated its liability in its books by $47,980, due to the loan from Forrester that was null and void because it violated Pub. Util. Code Section 825.

Based upon these conclusions, the 1997 Report recommended that the Commission take various measures to address Hillview's alleged misconduct. Among these recommendations were:

1. Hillview should refund to all affected customers all money unlawfully collected, together with 7% interest from the date collected until repaid.

2. Hillview should be fined at least $500 for each instance of charging an unauthorized fee for supply and storage.

3. Hillview should be fined at least $20,000 for having provided false information to the Commission, plus additional sums for submitting falsified documentation of individual customer charges.

4. Hillview should be ordered to pay $172,125, plus 7% interest, to reduce the $960,000 loan from CoBank, and the surcharges established to repay that loan should be reduced to reflect that $20,384 less in revenue is now needed.

5. The Commission should reduce the authority to borrow $540,000 from CoBank by $350,000, and correspondingly order Hillview to repay $350,000, the amount of the personal loan of Forrester and his wife, to CoBank. Further, Hillview should be ordered to remove from its records references to this loan as "Loan from Individual," adjust all pertinent accounts, and refile its annual report for 1992 and 1993 to reflect the corrected balances for Long Term Debt, Utility Plant, Accumulated Depreciation, and CIAC.
6. Hillview should refund to ratepayers the $24,080 annual excess revenues it has collected since March 1994, and reduce its current rates by $24,080.
7. Hillview should write off the $47,900 loan for lack of support, and file a revised annual report to reflect this change.

The 1997 Report also recommends that the Commission institute a second phase of this investigation to address all matters not resolved by the first phase.

The OII contemplated that after the PHC was held the respondents would serve prepared testimony in response to the 1997 Report, and the matter would then proceed to an evidentiary hearing. However, further proceedings were held in abeyance for more than two years after the December 4 PHC because of the Justice Department's then-pending criminal investigation, and the respondents were not required to respond to the Report at that time. On April 25, 2000, the ALJ issued a ruling (Ruling) to resume the investigation after receiving written confirmation that Hillview's records had been released by the Department of Justice, and that the criminal investigation had been closed.[5] See Ruling,

[5] This communication from the Department of Justice included an earlier letter to LWB staff, explaining that the criminal investigation was dropped because the statute of

Footnote continued on next page

Appendix A, p. 4 (Release Order dated November 4, 1999, of the Superior Court for the County of Madera in Case No. CR01558).

IV. The Motion for Adoption of the Settlement

On November 22, 1999, shortly after the investigative documents were released by the Department of Justice, RRB and Hillview filed the Motion. The grounds asserted in support of adopting the Settlement were:

> "(a) That [the] Settlement commands the unanimous sponsorship of all active Parties to this proceeding;
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> "(b) That the Parties are fairly representative of all affected interests;
>
> "(c) That no term of this Settlement contravenes any statutory provision or any decision of the Commission, and
>
> "(d) That this Settlement together with the record in this proceeding conveys to the Commission sufficient information to permit the Commission to discharge its regulatory obligations with respect to the Parties and their interest." (Motion, p. 2.)

The Motion also states that the Settlement is "reasonable in light of the whole record, consistent with applicable law, and in the public interest." (Id.)

The settling parties ask us to adopt the Settlement as a complete resolution of all issues in this proceeding, although they do not expressly ask us to dismiss the proceeding. The Motion is signed on behalf of RRB and Hillview by their respective counsel, but not on behalf of Forrester personally. The accompanying Settlement is signed by the staff witness on behalf of RRB, and by Forrester solely on behalf of Hillview.

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limitations had already run on the criminal offenses by the time that Department obtained our records.

Comments contesting the Settlement were filed by several interested parties, and objections in petition form were also received from nearly fifty Hillview customers.[6] Pursuant to Rule 51.6(b) the ALJ held a second PHC in Oakhurst on March 20, 2000, in order to establish a procedure to develop the record and consider whether to recommend adoption of the Settlement. The ALJ set a hearing for May 16 on all material contested issues of fact and law raised by the Motion and responsive comments, and required the settling parties, and any contesting parties who intended to participate in the hearing, to serve prepared testimony of all anticipated witnesses on the other parties.

The settling parties served no prepared testimony before the May 16 hearing. However, on April 20 they served a document titled, "Joint Report on the Reimbursement of Fees at Issue in the Investigation into Hillview Water Company's Operations, Rates, and Charges" (Joint Report) on other parties. The Joint Report is a brief explanation of how RRB prepared a list of some 250 customers upon whom Hillview may have assessed unauthorized supply and storage fees. The list is attached. It indicates whether or not RRB and Hillview consider each claim to be reimbursable. This Joint Report is not signed or verified, and does not address any contested issue raised in the OII.[7] Other than the written Motion and the attached Settlement, the Joint Report is the only item offered in support of the settling parties' request for adoption of the Settlement.

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[6] One comment was filed in support of the Settlement by Longs Drugs which expressed concern that Hillview will petition for bankruptcy if the Settlement is not approved, and customers would therefore be unable to obtain a full refund.

[7] The Joint Report was received as Ex. B at the hearing.

Staff Counsel, speaking on behalf of the settling parties, explained that they intended that the Joint Report supplement the information they had presented in the Settlement. (Tr., May 16, 2000, pp. 4-5.) The two documents were to comprise the settling parties' entire evidentiary presentation, although these parties additionally proposed to make the RRB staff witness available for cross-examination. Staff counsel assumed this procedure would be followed in lieu of service of prepared testimony required by the ALJ. Over objection by the interested parties, the ALJ permitted the hearing to proceed on this basis, and the Settlement and Joint Report were received as exhibits for the record.[8] The Prepared Testimony of Jane Cavin,[9] LWB's 1997 Report (with exhibits), and Hillview's 1994 Rate Base Calculations were also received for the record.

V. Terms of the Proposed Settlement

The Settlement is about two and one-half pages in length, excluding the attached customer list. In material part it provides:

1. As to Hillview's collection of supply and storage fees from customers, Hillview would refund to customers shown on the appended list a total of $247,930, plus 5% interest from the date of collection until the date of refund. A customer would have to furnish proof of payment of the fee, unless Hillview's records show that it had collected the fee. Refund of the fees (except for the interest) would be deducted from Hillview's CIAC.
2. As to the proceeds of the SDW loan, Hillview would deposit $35,314 into its Surcharge Savings Account, along with 5% interest from March 13, 1996, the date when Res.

[8] The Settlement was received as Ex. A.

[9] Cavin's prepared testimony was received as Ex. C; Hillview's 1994 Rate Base Calculations were received as Ex. E.

F-644 ordered Hillview to use excess surcharges to reduce borrowings from CoBank, until the refund of fees is made.

3. Hillview's disbursement of the refunds would be conditioned upon the receipt of a new loan. The proceeds of the new loan would be used not only to refund the supply and storage fees to customers, but also to make the refund to the Surcharge Savings Account, to refinance approximately $1.225 million on debt owed to CoBank, and to fund approximately $1,558,300 of proposed improvements to Hillview's system. Hillview would file an advice letter requesting authority to incur this debt.

4. Relating to the OII's provision requiring rate increase requests to be consolidated into this proceeding, RRB agreed to issue, within 90 days after the date of the Settlement, a report on Hillview's advice letter filed October 20, 1998, to obtain a general rate increase.[10]

5. As to other issues raised in the OII, the parties propose to agree (i) that RRB "accepts the statement of [Hillview]" that documents Hillview altered and submitted to RRB's auditor were not intended to mislead the Commission, and (ii) that Hillview would not be required to make a refund arising from overstatement of its ratebase in Res. W-3833, "in view of the offsetting effect" of subsequent additions.

VI. Discussion

We reject the proposed settlement because it fails to satisfy our criteria for adopting a settlement. However, we will grant Hillview's Petition to modify the OII in one respect. Our analysis follows.

[10] This provision is the subject of Hillview's petition to modify the OII.

A. Commission Criteria and Procedures for Adopting a Settlement

Rule 51(c) provides in part that parties may, by written motion, propose a settlement for adoption by the Commission in accordance with criteria and procedures set forth in Article 13.5 of our Rules (Rules 51 through 51.10). The motion proposing settlement must contain "a statement of the factual and legal considerations adequate to advise the Commission and parties not joining the agreement of . . . the grounds on which adoption is urged." Id. Once adopted, a settlement is enforceable as part of the Commission's order.

Not every settlement is adopted by the Commission, even though the supporting motion may contain the requisite statement of factual and legal considerations. Rule 51.1(e) precludes approval of any settlement, whether or not contested by other parties to the proceeding, "unless the . . . settlement is reasonable in light of the whole record, consistent with law, and in the public interest."

In judging the reasonableness of a proposed settlement, we have sometimes inclined to find reasonable a settlement that has the unanimous support of all active parties in the proceeding. In contrast, a contested settlement is not entitled to any greater weight or deference merely by virtue of its label as a settlement; it is merely the joint position of the sponsoring parties, and its reasonableness must be thoroughly demonstrated by the record.

B. The Settlement Is Rejected Because the Settling Parties Have Not Satisfied Their Burden, Procedurally or Substantively

The settling parties have not satisfied their burden under the foregoing principles. The settling parties did not comply with clearly stated procedural

requirements, thereby placing opponents of the Motion at a disadvantage, and they failed to satisfy the substantive requirements for adoption of the Settlement.

We also note that Hillview and RRB convened the settlement conference (required under Rule 51.1(b) before signing a Settlement) in Los Angeles, which is 265 miles from Oakhurst. Although this conference satisfied the literal requirements of that Rule, it certainly did not comply with its spirit. Under Rule 51.1(b) the conference should give all parties notice and an opportunity to participate. A settlement conference held 265 miles from this company's customers denied them that opportunity, as a practical matter.

1. The Settling Parties Did Not Support the Motion by Providing Prepared Testimony, as Required

Rule 51.6(a) specifies that, for a hearing on the contested issues of a contested settlement, the parties to the settlement must provide one or more witnesses to testify concerning those issues, and to undergo cross-examination by the contesting parties. To simplify the presentation of evidence on these issues, the ALJ required the settling parties and contesting parties who intended to participate in the hearing to deliver and serve prepared testimony in accordance with Rule 68. The contesting parties complied with this requirement; the settling parties did not.

As explained earlier, the settling parties chose to rely upon the Joint Report, Motion, and Settlement to satisfy this requirement without asking leave of the ALJ to make the substitution. This reliance was misplaced. The ALJ had established the prehearing procedure to give each side fair notice of the evidentiary support to be offered by the other, and provide a meaningful opportunity to prepare cross-examination. Given the skimpiness of the

Joint Report, the settling parties' failure to comply with this procedure effectively denied that opportunity to the contesting parties.

The settling parties also announced for the first time at the hearing that they would make the staff witness available for cross-examination. Not only did the settling parties' failure to provide this witness' prepared testimony in advance result in surprise to the contesting parties, but his testimony also indicates that his role in preparing the 1997 Report may have been quite attenuated.

This witness testified that he was "involved" in the investigation, preparation of the Settlement, and preparation of the Joint Report, but the only explanation of his involvement was that he guided the auditors and engineers assigned to the investigation. (Tr., May 16, 2000, pp. 59-69.) Counsel for respondents told the ALJ that the RRB witness was not the staff member who actually determined whether or not customers were entitled to refunds.[11] (Id., p. 36.) In short, this witness' competence to testify about the matters under investigation is unclear.

The contesting parties raised timely objection before evidence was taken, and although the ALJ permitted the hearing to proceed, as it turned out their objection had merit. The settling parties did not provide either prepared testimony or a witness clearly qualified to support the Settlement in light of the allegations in the OII and the 1997 Report.

[11] The staff member who performed this function was never identified by name.

2. The Settling Parties Did Not Provide an Adequate Statement of the Grounds Upon Which Adoption Is Urged

Rule 51.1(c) requires parties who propose a settlement for adoption to include in the written motion "a statement of the factual and legal considerations adequate to advise the Commission and parties not expressly joining the agreement of . . . the grounds on which adoption is urged." The Motion fails this standard of adequacy, because it simply paraphrases the criteria stated in Rule 51.1(e). We cannot grant the settling parties' request on the basis of these conclusory assertions. They must provide factual and legal support for these assertions.

The Settlement is not self-explanatory, and even with the supplemental information from the Joint Report, which deals only with the supply and storage fee refund issue, grounds for adopting the Settlement as a complete resolution of all issues are absent. In the OII we characterize these issues as "serious," and we note that the Settlement would leave unresolved significant allegations of wrongful behavior.

In the context of this investigation, any settlement must remedy past misconduct, ensure that such misconduct does not recur, and provide adequate assurance that customers will receive proper service. Here, if Hillview is to continue under the same management and pay refunds, there must be an explanation of the source of funds to remain in operation and maintain service and water quality. The Joint Report fails to do any of these things. There are too many damaging facts in the present record, and too many unfavorable allegations in the OII, to approve the Motion without a more concrete basis.

The procedural defects identified in the foregoing sections would justify rejection of the Settlement without further inquiry. However, the Settlement also has fatal substantive defects, to which we now turn.

3. The Settling Parties Have Not Shown That the Settlement is Reasonable in Light of the Whole Record, Consistent With Law, and in the Public Interest

The Motion also fails because the Settlement does not pass the fundamental substantive tests of Rule 51.1(e).

a) The Settlement is Not Shown to Be Reasonable in Light of the Whole Record

The record raises serious concerns about conduct by Hillview and its president, conduct that is neither explained nor remedied by the Settlement. These omissions from the Settlement are unreasonable, producing an outcome that would respond only partially to our concerns about the respondents' reportedly egregious behavior. This incomplete response is manifested in several ways.

First, Forrester, a respondent expressly identified in the OII, is neither a party to the Settlement nor a sponsor of the Motion,[12] and the Settlement does not address the allegations regarding his conduct. The 1997 Report indicates that he may have effectively used Hillview as a personal lending institution; if correct, this would be a particularly egregious abuse of his position. Nothing is mentioned in the Motion, Settlement, or Joint Report about this issue, and by settling all issues the Settlement would summarily absolve him of any consequences from his alleged misconduct.

The Settlement also fails to address many of the key concerns about the respondents' behavior that we identified in the OII and that LWB later corroborated and described in the 1997 Report. If we adopt the Settlment in its present form, we will foreclose further inquiry into the merits of many of the findings of the 1997 Report without ever addressing their validity. The result would be significant unresolved factual issues and possible violations of law that the Settlement would excuse by its silence.

These omissions are significant in relation to what we know from the record. For example, although Hillview would be required to deposit $36,314 of the proceeds of the SDW loan in its Surcharge Savings Account, no explanation is offered nor any sanction imposed by the Settlement regarding the improper use of these loan proceeds. Similarly, the Settlement does nothing to address uncontradicted facts in the record indicating that Hillview misrepresented the need and intended use for loan proceeds obtained under Commission authority, or that Forrester and Hillview improperly engaged in self-dealing and arranged financing from developers and other third parties without the Commission's knowledge or authority.

At the hearing the settling parties characterized the Settlement merely as a device for "turning back the clock," transforming contributed plant that has been financed by the customers into rate base financed by the company. (Tr., May 16, 2000, pp. 25-26.) No penalty would be imposed for the respondents' misbehavior (if any), and there is no feature included to prevent the recurrence of the type of conduct that prompted the investigation.

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[12] We note that CSD also is not a party to the Motion or the Settlement, despite the language of the OII, but we assume that RRB is now taking CSD's role.

This is an unreasonable result in light of the damaging allegations in the record that have not been contradicted in any way by the settling parties.

Finally, the Settlement is not reasonable in light of this record because, for the key issues the Settlement does address directly, the resolution is unreasonable. The provision for refunding wrongfully collected fees, the central feature of the Settlement, lacks any terms or conditions which would afford comfort to customers. Most significantly, the obligation to make the refund is contingent upon Hillview's obtaining a new loan. Although Hillview has expressed confidence in the prospect of obtaining the loan once the Settlement is approved, the process could be delayed indefinitely while a lender is being sought and acceptable terms are negotiated. Moreover, at the hearing Hillview revealed for the first time that the funding of the refunds may not be from loan proceeds, but from the issuance of bonds -- a prospect that is not even mentioned in the Settlement. (Tr., May 16, 2000, p. 55.)

The Settlement also contains a de facto cap on the dollar amount of refunds Hillview would be obligated to make, based upon RRB's current compilation of the refunds which are due. This is unreasonable in light of testimony which clearly indicates that the list of claimants (and therefore the total dollar amount of refunds) is incomplete, and that a more comprehensive claims procedure is needed. Hillview must refund improperly collected fees, regardless of the fact that the parties have agreed upon a figure to set aside for that purpose. Placing any limit on the amount of refunds is unreasonable in light of the settling parties' admission at the hearing that some claims may have been overlooked, and that some customers may not receive refunds.
(Tr., May 16, 2000, p. 120.)

Specifically, the RRB witness testified that the list of refundable fees attached to the Joint Report was developed by first sending a letter to each Hillview customer of record as of April 30, 1997, and then comparing the responses to entries in Hillview's ledgers showing each supply and storage fee collected by the company. This procedure overlooked some customers who were renters, or had moved, died, or inadvertently been omitted when the letter was sent. Cavin testified that there were serious inconsistencies in Hillview's records of the supply and storage fees she and her husband paid for several properties. Some of the letters to customers were returned unopened, and no effort was made to locate the customers to whom they had been sent. RRB did not consider that some of the persons impacted by the refund program were not customers of record. (Tr., May 16, 2000, p. 101.) The RRB witness was not certain that the efforts of his staff had identified every customer who paid a fee that is subject to refund. (Id., p. 120.) All of this testimony points to a flawed procedure for notifying customers about the potential refunds.

The Settlement also has no provision for resolving disputes about refunds that would be denied by RRB. At the hearing Commission staff conceded that any customer who did not receive a refund as determined by RRB's list would have to resort to filing a formal complaint with the Commission to seek relief, because the Settlement includes no procedure to handle this problem. Staff counsel's response to questions about these shortcomings was that the settling parties would consider any suggestions about improving the refund procedure if someone had a better idea. (Tr., p. 43.) Having to open new formal proceedings to close out some of these claims is unreasonable, particularly because the record demonstrates that Hillview may have wrongfully collected supply and service fees as early as 1984. We instituted this

investigation to afford a final remedy to Hillview's customers for that conduct, and the Settlement should provide a means for fully and finally resolving all claims in order to be reasonable.

In addition to the contingency that Hillview must obtain a loan before making the refunds, the Settlement lacks other assurances that refunds to customers will be made on a reasonable basis. Hillview is subject to no time constraint that would require or encourage it to make timely refunds, nor any sanction for failing to do so. A requirement that the current owners sell the company at a price reflecting its correctly stated rate base and refund obligations if it failed to meet a deadline, for example, would provide an appropriate incentive for Hillview to process refunds promptly. We adverted to the possible imposition of this sanction in our OII.

b) The Settling Parties Have Not Shown That the Settlement is Consistent With Law

Various features of the Settlement are inconsistent with basic rights of Hillview's customers. Hillview concedes that customers who paid supply and storage charges which are unlawful under Hillview's Tariff Rule 15 are entitled to refunds. However, the specific dollar limitation in the Settlement on the amount of refunds to be made, coupled with the moving parties' admission that the total figure may not include all potentially legitimate claims, could operate to foreclose refunds that are lawfully due. We are unaware of a provision of law that would excuse Hillview from the obligation to pay each and every legitimate refund claim, and the moving parties have not shown that any such exception exists.

For the same reason, the fact that the Settlement effectively makes payment of the refunds contingent upon Hillview's obtaining a loan is not

consistent with the law. At the hearing the RRB witness testified that Hillview could reasonably be expected to obtain the loan, and would be in violation of the Commission's order if it did not. Although it appears very likely that Hillview will seek a loan to make the refunds, the Settlement provides no guarantee that this will occur, and the refund provision is not consistent with the company's strict legal obligation to ensure that the refunds are made. At the hearing Hillview indicated for the first time that it may seek funds through the issuance of bonds, which would further confuse this obligation by departing from the literal requirements of the Settlement. Moreover, contrary to RRB's assertion, Hillview would not necessarily violate the literal terms of the Settlement by withholding refunds if those refunds are linked to obtaining the loan. In short, this provision of the Settlement is not rigorously consistent with Hillview's legal obligations.

The Settlement is also legally flawed with regard to the treatment of Hillview's overstated rate base. The Settlement would excuse Hillview from making a refund by reason of the overstatement of its rate base in Res. W-3833, on the rationale that subsequent additions to Hillview's rate base have "offset" the effect of this overstatement. Mrs. Forrester, the company's office manager, could not provide an accurate figure in her testimony for the post–1994 plant the company has put in service, and could not even testify how many years the company has operated "in the red." No other testimony was offered on this subject. In light of the questionable reliability of the available testimony, we cannot assume that the amount of offsetting additions equals the amount of overstated rate base. Moreover, the RRB witness testified that no field audit was conducted to determine if the plant additions were actually made as claimed, and thus we have no basis to conclude that the Settlement would

produce just and reasonable rates in this regard. We cannot approve an agreement that amounts to mere "horse trading." The settling parties have failed to carry their burden of demonstrating the legality of their agreement.

c) The Settling Parties Have Not Shown That Settlement is in the Public Interest

The public interest requires a settlement to address the concerns we express in the OII, with the object of correcting past violations and preventing a recurrence of offensive conduct. The Settlement here does neither. The moving parties stated only that its purpose is to "turn back the clock."

We have already discussed the flaws in the refund claims procedure, which could result in the loss of refunds by several classes of customers. The public interest will not be served unless complete relief is reasonably available to all customers who were harmed by Hillview's behavior.

As to deterrence of future misconduct, we are struck by the absence of any penalty in the Settlement in light of the conclusions and recommendations of the 1997 Report. The basic premise of the Settlement completely disregards significant allegations of wrongdoing that have not been admitted, denied, or explained in any way by the respondents. The RRB witness admitted that it is "a possibility" that the fees collected may have been used for purposes other than utility plant. (Tr., May 16, 2000, p. 130.) Simply requiring refunds does not go far enough to redress these problems or deter Hillview from future violations. Moreover, deterring Hillview from future misconduct would discourage the owners of California's many other small water companies from engaging in such behavior.

Much of the contesting parties' testimony was directed to the Settlement provisions requiring Hillview to pay 5% interest on improperly

collected fees and other funds, rather than paying either a higher commercial paper rate, or the 7% rate suggested by the 1997 Report, or the legal rate under the California Civil Code. The only relevant testimony offered by the settling parties was that Hillview inappropriately collected the supply and storage fees because it misunderstood the requirements of Tariff Rule 15, and that the fees were invested in short-term instruments with a return of approximately 5%. Whatever Hillview's reasons were, the record is silent as to the interest payable according to our usual practice in a reparations case, whether 5%, 7%, or some other rate. While this question is not now before us because we are rejecting the Settlement, there is no basis in the record for varying from that practice when the refunds are made.

The Settlement has been strenuously criticized by a substantial number of Hillview's customers, who either signed a petition form containing comments, or sent letters or e-mail correspondence to the ALJ.[13] Ensuring that the Settlement is in the public interest is our paramount concern in determining whether or not to approve it, and we take these criticisms seriously. The comments we have received and the hearing testimony strongly indicate that the Settlement would not serve the public interest, and the settling parties have not shown otherwise.

Moreover, throughout this decision we have alluded to the existence of gaps in the Settlement that would frustrate our ability to carry out future regulatory obligations to the parties and their interests. Specifically, the

[13] These documents are lodged in the correspondence portion of the record of this proceeding.

goal of "turning back the clock" is altogether too vague in light of (1) the contingent nature of Hillview's obligation to make refunds under the Settlement, (2) flaws in the claims procedure which could foreclose the payment of legitimate claims, and (3) the absence of a factual basis for excusing Hillview's obligation to make refunds relating to the overstatement of its rate base in Res. W-3833. As a consequence of these shortcomings in the Settlement, we would be unable to ensure that customers are repaid the fees and service charges they should not have had to pay.

The OII provides that, "a separate phase of this proceeding may be used, if violations are found, for the purpose of determining what the utility's revenue requirement should be, and to ensure that any wrongful charges assessed to consumers are refunded." However, the moving parties offer the Settlement as a "complete resolution" of all issues in this proceeding, despite Hillview's admission that its supply and service charges were assessed in violation of its tariff. Other possible violations of statutes and rules would also be overlooked if we accept the Settlement as a complete resolution of the proceeding, and we would negate our ability to schedule a new phase of the proceeding to address unresolved compliance issues.

We cannot permit the Settlement to disable us from carrying out our future regulatory responsibilities to Hillview's customers. This proceeding requires full consideration of the issues we raised in our OII, the factual conclusions reached by LWB in the 1997 Report, and the reasonable consequences which should attend Hillview's misconduct. The Settlement does not accomplish this. At best, it is a sop to aggrieved customers, and only a partial discharge of our regulatory obligations to them. It does not go far enough, and we cannot approve it.

C. Hillview's Petition to Modify the OII is Granted in Part

On September 20, 2000, Hillview petitioned to modify I.97-07-018. Hillview asks us to delete the requirement in the OII that all proposals to increase rates and other new charges be consolidated with this enforcement proceeding for consideration.[14] The petition argues that the company desperately needs a rate increase and authorization to recover costs and charges set forth in various pending advice letters filed since 1997, and that new rates will permit a lender to ascertain the company's future cash flow and ability to service new debt. Hillview believes that the current requirement to consolidate requests for these increases could delay any relief until we close the OII. RRB opposed the petition on the grounds that Hillview is earning "far in excess" of its authorized rate of return in RRB's opinion, and that the intent of the OII, making Hillview's rates subject to refund and specifying that this proceeding will assess whether the utility's revenue requirement and rates or charges should be reduced, is inconsistent with Hillview's petition. However, RRB has since resolved its differences with Hillview as to the level of Hillview's earnings under current rates. (See D.01-10-025 (October 10, 2001), in which we approved an

[14] The specific provision Hillview seeks to modify is Ordering Paragraph 7, which says, "Until further order, any proposals to increase rates or charges submitted to the Commission on behalf of Hillview, as well as any individual complaints against Hillview, shall be consolidated with this enforcement proceeding for consideration." Hillview proposes, without providing suggested language, that we "eliminate the requirement that all rate increases and other new charges to Company customers be consolidated in the OII." As explained in the text, the modification we make today is, apparently, more limited than Hillview's proposal.

agreement between Hillview and RRB that included RRB's stipulation that Hillview's "present rates are just and reasonable.")

We began this investigation (now in its fifth year) intending to address and to resolve comprehensively our staff's allegations against the respondents of many serious financial irregularities. To that end, we directed that any rate increase or other adjustment sought by Hillview during the investigation would be consolidated with it. But the investigation has been delayed. Most notably, the now-abandoned criminal investigation tied up the matter for over two years. The flawed Settlement, however well-intended, has led to further delay. In the meantime, Hillview is experiencing service problems that threaten to compromise the quality and quantity of its water supply. (See generally D.01-10-025; under that decision, a moratorium on new connections is now in effect for Hillview.) We must now face two necessities: making Hillview's customers whole (if the allegations of financial irregularities are sustained); and ensuring that Hillview's customers receive safe and reliable service. While we still desire a comprehensive resolution, we cannot let service problems go unaddressed while pursuing that resolution.

We conclude that our regulatory duties can best be carried out by modifying the OII, though not to the extent that Hillview suggests. Specifically, Hillview may now separately seek rate relief or other authorizations from us where needed to address service issues, as discussed above. We stress that, in so modifying the OII, (1) we prejudge no issue in the OII, and (2) we do not change the burden on Hillview to explain and justify fully any rate relief or authorization it may separately seek during this investigation. Finally, except as discussed above, we retain the requirement of the OII that individual complaints

filed against Hillview, and any proposals by or on behalf of Hillview to increase its rates or charges, be consolidated with this investigation.

VII. Conclusion

Our order today paves the way for promptly concluding this proceeding. We deny the motion to adopt the Settlement, as that document falls short of satisfying our standards for approval. We grant, in part, the Petition to Modify so that timely action can be taken on Hillview's service problems. We are open to considering a revised settlement that meets the concerns we have discussed; failing that, we direct the ALJ to bring the matter to hearing as soon as possible.

VIII. Comments on Proposed Decision

The proposed decision of ALJ Victor Ryerson in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311(d) and Rule 77.1 of the Rules and Practice and Procedure. Timely comments were filed by respondents Hillview and Forrester, and by the Water Branch of the Commission's Office of Ratepayer Advocates (ORA), on December 11, 2000.[15] No reply comments were filed.

Rule 77.3 governs the scope and content of comments on a draft decision. Among other requirements, the rule specifies that comments shall focus on factual, legal or technical errors in the draft, and that new factual information, untested by cross-examination, shall not be relied upon as the basis for assertions made in post publication comments. The respondents' comments rely heavily on both and, likewise contrary to the intent of Rule 77.3, tend to make new

[15] ORA is the successor to LWB and RRB in relation to the events reported in the draft decision.

arguments or reargue those which they made earlier. Many of these arguments are offered on the basis of new information, which is not in the record, or statements of counsel rather than testimony. We cannot accord any weight to such matter.

More importantly, the respondents' comments do not bring forth any factual, legal, or technical errors that would materially negate the ALJ's analysis of the Settlement. Indeed, these parties admit in their comments that the claims procedure in the Settlement "may not be perfect;" express a willingness "to modify the Settlement;" and point out that they wrote a letter to the ALJ on July 7, 2000, to modify the refund procedure in a manner that was not before the parties at the EH. They characterize Forrester's failure to execute the Settlement as an "oversight," and offer to make him a party. In short, these comments admit that the Settlement has shortcomings, but expect the Commission to fix it.

The respondents urge that approval of this Settlement is a "necessary condition for the Company to be able to raise funds to address . . . customer concerns" about making improvements desperately needed to maintain water supply and quality for Hillview's customers. We do not agree. We believe that this objective can be achieved just as successfully in a settlement that satisfies our criteria for adoption.

We have made some nonsubstantive factual corrections in response to the respondents' comments, and we have also changed the result concerning the petition for modification of the OII.

ORA'S comments merely argue that the solution proposed in the draft decision would only lead to "additional, unnecessary delay." We do not perceive this to be the case. The groundwork for accomplishing the company's longstanding need for improvements was laid in D.01-05-006 (May 3, 2001), in

which we authorized Hillview to borrow up to $25,000 under the Safe Drinking Water State Revolving Fund to perform studies and preliminary engineering. With respect to the resolution of other issues, we will not sacrifice justice in the interest of expedition. We welcome any timely effort the parties may make to revise the Settlement, if in so doing they correct deficiencies in the current version identified in the decision. If a revised settlement satisfies the requirements of our rules, we can and will accord it prompt consideration for approval.

Findings of Fact

1. The Motion for Adoption of Settlement is signed on behalf of RRB and Hillview only.

2. The Settlement is signed on behalf of RRB and Hillview only.

3. The Motion is opposed by several interested parties.

4. Timely comments contesting the Settlement were filed on behalf of several interested parties.

5. Objections to adoption of the Settlement were received from numerous Hillview customers who are not parties.

6. The moving parties served no prepared testimony regarding the Settlement, contrary to direction by the ALJ.

7. There is no adequate showing in the record that the Settlement is reasonable in light of the whole record, and certain features of the Settlement are unreasonable.

8. The procedure for refunding wrongfully collected supply and service charges under the terms of the Settlement is not complete and comprehensive.

9. There is no showing in the record that the Settlement is consistent with law.

10. There is no adequate showing in the record that the Settlement is in the public interest, and various features of the Settlement are contrary to the public interest.

11. The parties who sponsor the Settlement have made no showing that the Settlement does not contravene statutory provisions or prior Commission decisions, despite the inclusion of a refund procedure that has a potentially discriminatory effect upon customers who are entitled to refunds.

12. The Settlement does not convey sufficient information to enable us to discharge our future regulatory obligation to administer the payment of refunds to customers, and to ensure that Hillview's rates are based upon an appropriate rate base and other factors.

13. The Settlement does not convey sufficient information about alleged violations by the respondents to enable us to conduct a second phase of this proceeding as contemplated by the OII, or to make a determination whether such a second phase is required.

14. Hillview's Petition to Modify the OII may be granted so as to timely address Hillview's service problems while pursuing comprehensive resolution of the issues in this investigation.

15. This decision should be made effective immediately because of the urgent need to resolve issues posed in the OII.

Conclusions of Law

1. The settling parties did not satisfy the procedural requirements for supporting their motion under Rule 51.6(a).

2. The settling parties did not provide an adequate statement of the grounds upon which adoption of the Settlement is urged.

3. The settling parties have not shown that the Settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

4. The motion for adoption of the Settlement should be denied.

5. Hillview's Petition to Modify the OII should be granted in part.

O R D E R

IT IS ORDERED that:

1. The Motion to Adopt Settlement filed by Hillview Water Company, Inc. (Hillview), and the Ratepayer Representation Branch of the Commission's Water Division is denied.

2. Hillview's Petition to Modify Ordering Paragraph 7 of the Order Instituting Investigation 97-07-018 is granted to the extent set forth in Section VI. C. of the foregoing Opinion, and except as granted therein the Petition is desired.

3. The assigned administrative law judge in this proceeding shall, by written ruling, promptly establish a procedure for bringing this investigation to an orderly conclusion, including scheduling an evidentiary hearing in Oakhurst at the earliest possible time.

This order is effective today.

Dated _____, at San Francisco, California.